SUPREME COURT, U. S.

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1213

OLIVER R. GRACE, et al.,

Petitioners,

against

DANIEL K. LUDWIG, et al.,

Respondents.

BRIEF FOR DEFENDANTS-RESPONDENTS LUDWIG, BERKSHIRE AND AMERICAN-HAWAIIAN IN OPPOSITION TO PETITION FOR CERTIORARI.

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BRIEF FOR DEFENDANTS-RESPONDENTS LUDWIG, BERKSHIRE AND AMERICAN-HAWAIIAN IN OPPOSITION TO PETITION FOR CERTIORARI.

Defendants Daniel K. Ludwig ("Ludwig"), Berkshire Industries, Inc. ("Berkshire") and American-Hawaiian Steamship Company ("American") submit this brief in opposition to plaintiffs' petition for certiorari. The Second Circuit's decision below is reported at 484 F.2d 1262 (1a).*

Counter-Statement of Questions Presented

1. Are investment company stockholders entitled to a multimillion dollar fee from their company because, in a proceeding under § 17 of the Investment Company Act (the "Act"), they undertook, without anybody's request, to

* Unless otherwise indicated, figures in parentheses refer to pages of the petition and its appendices.

assist the SEC in doing what the Commission was required by law to do in any event, namely, to prevent an unfair merger of the investment company?

2. Is not such a fee claim also precluded because, even without the stockholders' assistance, the SEC would in any event have rejected an unfair merger?

3. Can the stockholders demand a fee because of "harassment" and "fraud" in the SEC proceeding, when actually—apart from other obstacles—they participated in the proceeding of their own volition and when, by their own assertion, neither they nor the SEC were deceived by the alleged misrepresentations?

4. Even if a fee could be allowed, would not the task of awarding it reside with the SEC, since the Commission —otherwise than a court— is familiar with the merits of the application, the course of the proceedings and the contributions of private participants as compared with those of its own staff?

Summary Statement of the Case

Plaintiffs sue to recover $10 million as legal fees allegedly earned by them in an SEC proceeding under § 17 of the Act. The section (2a) forbids an investment company to merge with its parent; but the SEC may, upon application, grant an exemption if evidence establishes that the transaction is fair, free of overreaching and consistent with the purposes of the Act. Pursuant to § 17, Berkshire applied to the SEC for leave to absorb by merger its 91% subsidiary, American, a closed-end investment company, and to pay cash for the minority stock of American. The SEC directed a hearing.

Plaintiffs are minority stockholders of American and their counsel ("LLB"). At the SEC hearings they opposed Berkshire's cash offers as insufficient. Berkshire successively increased its offers from $275 to $650 a share,* but the offers were not accepted and lapsed. After two years of protracted proceedings, and with no end in sight, Berkshire withdrew its application. Plaintiffs contend that their participation in the SEC proceeding conferred a great benefit on American; they deem themselves entitled to a $10 million fee for their 2,085 hours of service—about $5,000 per hour.

The SEC denied plaintiffs' fee application for lack of jurisdiction. Instead of seeking review of that decision under § 43 of the Act, plaintiffs brought this action in the District Court for Southern New York. They sued American as the alleged beneficiary of their efforts. They also sued American's parent, Berkshire, and the latter's parent, Ludwig, for harassment and fraud in allegedly understating the value of American's stock in the SEC proceeding. Alternatively, plaintiffs sought a partial recovery from three other minority stockholders (defendants Weininger, Premier Investing Corp. and Korsen).

After completion of all pretrial discovery and the filing of an amended complaint, the parties cross-moved for judgment on the pleadings or summary judgment. Plaintiffs submitted a 40-page affidavit of their counsel, together with the entire 7,500-page SEC transcript, all the 550 SEC exhibits, and the entire pretrial discovery record. The Dis-

* The increased offers reflected the rise, over two years, in the value of American's assets, due to progress in the development of its undeveloped properties and to the sale of certain assets at unexpectedly high prices. For present purposes, however, we accept arguendo plaintiffs' claim that the increased offers were "very largely" due to their efforts (7).

trict Court (Knapp, J.) held that the amended complaint, as amplified by plaintiffs' other papers, failed to make out a claim for relief. Since the decision was based on the affidavit and exhibits, it was in the nature of summary judgment.*

The Second Circuit affirmed (484 F. 2d 1262, rehearing and rehearing en banc denied; 1a, 11a, 12a). Prior to its decision, the Court asked the SEC for an amicus brief (15a-16a). The Commission declined but indicated that, even without plaintiffs' participation in the SEC proceeding, the Commission and its staff would hardly have sanctioned a violation of the Act, i.e., an unfair merger (17a-18a). In a post-decision letter, the SEC "[took] no position with respect to the result reached by the Court;" it noted its refusal of plaintiffs' request to file a brief in support of their petition for rehearing; but it asked the Court to delete the last paragraph of its opinion (19a-23a). Actually the Commission's remarks were addressed only to three sentences which it quoted (20a). The sentences, a minor part of the decision, sugggested that an excessive number of private participants in SEC proceedings might hamper the Commission (10a). The SEC stated that private participants should not be discouraged because, in certain circumstances, the Commission may need their help to discharge its statutory duties. The Commission did not, however, recede from its previous statement that, *in the present case,* it would have rejected an unfair merger of American even without plaintiffs' assistance.

The Court refused to change its opinion (29a) and, thereafter, unanimously denied rehearing and rehearing en banc (11a, 12a).

Further factual details will be referred to in the context of our argument.

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*FRCP 12(c); *Carter* v. *Stanton,* 405 U.S. 669, 671 (1972).

Reasons for Denying the Writ

In the forty years since the creation of the SEC, not a single court has awarded fees to a participant in an SEC proceeding. As the Court below noted (6a, 9a), plaintiffs' claim is without precedent. In analogous fields, the authorities have unanimously rejected similar fee claims (8a). In any event, the Court below has convincingly demonstrated the complete lack of merit of this action.

In the absence of any authority supporting their claim, plaintiffs rely on the SEC's letter suggesting that, in certain circumstances, a private participant's assistance may be necessary to help the Commission in discharging its duties under the Act. We do not think that even such necessary assistance would be a basis for a fee award; but that is a question for another day. In the present case, plaintiffs' assistance to the SEC was *not necessary*. The Court below found neither an allegation nor any evidence in the record that " 'but for' the LLB intervention the SEC would have granted [Berkshire's] application" (7a-8a). The Commission, in effect, said the same (18a). It is thus simply fanciful for plaintiffs to assert that their participation in the SEC proceeding "provide[d] a necessary supplement to Commission action" (11, 13). The SEC could and would have rejected an unfair merger without plaintiffs' help; and it would have done so without any expense to its statutory wards, the investment company and its stockholders. These wards cannot now be made to pay a multi-million dollar fee for plaintiffs' unsolicited and unnecessary services.

I.

Plaintiffs are not entitled to a fee for voluntarily assisting the SEC in doing what the Commission was required by law and was perfectly able to do in any event.

1. It is elementary that, ordinarily, a successful litigant cannot recover his counsel fees (other than statutory costs) from his adversary; *Fleischmann Distilling Corp.* v. *Maier Brewing Co.*, 386 U.S. 714, 717 (1967). An exception permits the successful plaintiff in a stockholder's derivative or other class action—including suits under the federal securities laws—to recoup his litigation expenses from the class or corporation on which he has conferred a substantial benefit; *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 389-397 (1970). Plaintiffs predicate their argument on the *Mills* case.

That case holds, however, that the allowance of fees in derivative and class actions depends on the presence of "special circumstances . . . that would justify an award of attorneys' fees"; *Mills*, 396 U.S. at 391. Most important, a volunteer champion cannot represent a class, or collect a fee from it, if the corporate or class rights are adequately protected by an agency duly appointed for that purpose. There is no room for a self-appointed private attorney-general and his fee claim, unless the class rights are jeopardized by the absence, hostility or inadequacy of the agency normally charged with their protection. Thus a stockholder's derivative action does not lie if the board of directors is free of antagonistic interests and duly performs its functions.* A class of creditors duly represented by a

* FRCP 23.1; *United Copper Sec's Co.* v. *Amalgamated Copper Co.*, 244 U.S. 261, 263-64 (1917); *Corbus* v. *Alaska Treadwell G.M. Co.*, 187 U.S. 455 (1903).

receiver need not pay compensation to a class member who voluntarily adds his efforts to those of the receiver in enforcing class claims.* Most pertinent here, there can be no fee award to a class member for voluntarily assisting a public agency appointed by law to protect the corporate or class rights, *Edison Light & Power Co.* v. *Pennsylvania Pub. Utilities Com'n,* 34 F. Supp. 939, 942-43 (E.D. Pa. 1940), *aff'd an opinion below,* 119 F. 2d 779 (3rd Cir. 1941); *Casey* v. *Woodruff,* 49 N.Y. Supp. 2d 625, 647-49 (S. Ct. 1944).

2. The SEC is such a public agency. Under § 17 of the Act, the Commission can grant the requisite exemption for an investment company merger only upon formal application and only if evidence establishes that the proposed merger is fair, free of overreaching and consistent with the purposes of the Act. Rule 9(a) of the SEC Practice Rules, 17 CFR § 201.9(a), provides that "[t]he interested division of the Commission shall be deemed a party to all proceedings". Needless to say, the role of the division, as a *party,* is by no means neutral or "quasi-judicial", as plaintiffs contend. The statute and Rule insure a critical and adversary administrative review of the issue of fairness.

In the present case, the SEC was thus the agency entrusted by law with the protection of the class rights, and it squarely shouldered that responsibility. The Commission's staff (the then Division of Corporate Regulation) made a preliminary examination of Berkshire's application (App. below 127A). The Commission then directed a full hearing on notice to all stockholders of American. Throughout the lengthy hearings, the staff by its counsel took an active part and thoroughly cross-examined each of the wit-

**Thomas v. Peyser,* 118 F. 2d 369, 373 (D.C. Cir. 1941); *In re New York Investors,* 79 F. 2d 182, 186 (2d Cir. 1935); see *Restatement, Restitution* § 115, comment a, at 481-82 (1937).

nesses. Plaintiffs suggest that the services of staff counsel were less than adequate, but the Court below, with the complete SEC record before it, rejected that contention (8a). Plaintiffs' assertion that their counsel pulled the laboring oar at the hearings "does not at all establish that the vessel would have otherwise foundered" (*id.*).

Under settled law, "the presumption of regularity supports the official acts of public officers and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties"; *U.S.* v. *Chemical Foundation*, 272 U.S. 1, 14-15 (1926); see 2 *K. Davis, Administrative Law*, § 11.06 (1958). The SEC and its counsel must, therefore, be presumed to have done their duty, unless "clear evidence to the contrary" rebuts the presumption. As noted, the Court below found neither an allegation nor any evidence in the record that "'but for' the LLB intervention the SEC would have granted [Berkshire's] application" (7a-8a).* The Commission rejected the insinuation that, without plaintiffs' help, it would have sanctioned a violation of the Act, i.e., an unfair merger (18a). The Commission thus afforded full protection to American and its minority stockholders, and the Court below was clearly right in holding that plaintiffs, as mere volunteer helpers, are not entitled to a fee from them (8a).

3. The decision below is plainly consonant with *Mills*, *supra* (396 U.S. 375). That case was a stockholders' action to set aside a merger on the ground of proxy fraud. The action was necessary, for the board of directors was antagonistic (p. 378) and the SEC neither could nor did bring the suit. The class rights would thus have been lost if the

* Plaintiffs' contention that the Court below should have permitted them to amend the complaint is unfounded. Plaintiffs did not ask for leave to amend; they had filed an amended complaint once before; and in light of the complete SEC record before the Court, a further amendment would have been futile.

plaintiffs had not enforced them. In the present case, the SEC actively and effectively protected the class rights.

Plaintiffs' other authority, *Blau* v. *Rayette-Faberge, Inc.*, 389 F. 2d 469 (2d Cir. 1968), is similarly distinguishable; the plaintiff there was entitled to a fee because "the corporation ha[d] been, and [was] likely to be, inattentive to its rights" (p. 473). No such inattention is here chargeable to the SEC.

4. Nothing in the SEC's post-decision letter to the Court below (19a-23a) suggests anything different. The Commission was careful to state that it was taking no position with respect to the result reached by the Court (19a). Nor did the SEC retreat from its pre-decision statement that, even without plaintiffs' help, it would not have sanctioned an unfair merger (18a). The Court's thrice-repeated holding to the same effect (7a, 8a, 9a) expressly quoted this statement of the SEC (7a); and the Commission's later letter did not question either the Court's holding or its use of the Commission's earlier statement. Moreover, the Commission noted that it had declined plaintiffs' request to file an amicus brief in support of their petition for rehearing (19a).

The SEC's post-decision letter addressed itself merely to a three-sentence passage in the Court's decision (20a) which, the SEC apprehended, might be troublesome in future cases. The Commission suggested that private participation in its hearings might, at times, be helpful and should therefore not be discouraged. It noted that information from private parties may be needed in the frequent cases where § 17 applications are granted without hearing and, hence, without full-scale staff investigation of the one-sided evidence of the applicants.* Plainly, this is not the

* Plaintiffs' quotation (10) of this passage of the SEC letter completely distorts it by combining into one sentence two bits of language actually separated by a full page of the letter.

present case; for here the SEC—long before it heard from plaintiffs—did order a full hearing. At that hearing its staff could and did "conduct a full-scale investigation of the merits of the application".

The SEC suggested that the denial of a fee to a party supplying it with relevant information might induce that party to by-pass the administrative proceeding and to mount a collateral attack on the transaction in the district court, where a fee might be awarded (22a-23a). Again this is not our case. The SEC did not suggest that plaintiffs had supplied it with otherwise unavailable information; on the contrary, it stated, in effect, that even without plaintiffs' assistance it would not have approved an unfair merger of American (18a). We note, therefore, only in passing that an interested party foolhardy enough to withhold relevant data from the SEC may well be estopped from asserting them by way of collateral attack on the Commission's decision or from claiming a fee for doing so.

5. To sustain fee actions such as that at bar would subject the courts to overwhelming and, indeed, wholly impractical burdens. Numerous administrative agencies—the SEC ICC, FTC, FPC, FCC and many others, not to speak of countless state administrative agencies—conduct a great variety of proceedings in which they are charged with the protection of security holders or consumers or other interested classes. Permission to participate in these proceedings is frequently granted to interested parties. On plaintiffs' theory, each such proceeding could be followed by one or more plenary actions, in which the participants would seek fees for benefits allegedly conferred by them on others in the administrative proceeding. It does not strain the imagination to visualize the flood of litigations that would engulf the courts upon adoption of such a rule.

Fee actions of this sort would not even depend on participation in a formal administrative proceeding. Thus the SEC's preliminary examination of proposed proxy statements is necessarily casual and perfunctory; see *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432-33 (1964), discussed by the Court below (6a-7a). A letter from a private stockholder furnishing some information might, therefore, assist the SEC in its review. Is every such letter to become the basis for a fee action in federal court, on the theory (22a) that "it is essential for effectuation of the policies of the Act that [a person having relevant information] bring his views to the Commission's attention"?

What is more, the resolution of the issues posed by this and similar actions would subject the courts to tasks they are incapable to perform. In each case the court, although far removed from the agency proceeding, would have to retrace that proceeding (here, 7500 pages of transcript and 550 exhibits) and would have to determine, on the strength of a cold record, the nature and amount of the benefit allegedly achieved, the comparative contributions of the agency and of various participants, and the fair value of each such contribution. The effect which a participant's evidence or argument may have had on the disposition of a case will often depend on the agency's unarticulated mental operations; under familiar law, a court cannot explore those mental operations, *U.S.* v. *Morgan*, 313 U.S. 409, 421-22 (1941). In short, the Court below rightly held that the task of measuring the value of plaintiffs' services would be "impossible" for a court (10a).

If a fee were to be awarded at all for services of this kind, only the administrative agency could do so. Only the agency is intimately familiar with the proceedings before it, has observed the various participants in action, can

assess their contributions, and can appreciate the subtle interplay of factors culminating in the ultimate disposition of the case. According to the SEC's letter below, the Commission has at times granted § 17 applications on condition that the applicant pay a counsel fee to a private participant (22a). If that be true,* plaintiffs should have challenged the SEC's avowal of lack of jurisdiction to attach a similar condition to its order permitting Berkshire to withdraw its application. Plaintiffs, however, failed to seek review of the Commission's jurisdictional ruling under § 43 of the Act. Certainly, the SEC's refusal cannot shift the task to a court, which is not qualified to perform it.

We submit that plaintiffs are not entitled to a fee for voluntarily assisting the SEC in doing what the Commission was required by law, and was perfectly able, to do without plaintiffs' help. But if there were to be a fee award, only the Commission, not a court, could make it.

II.

Plaintiffs have no fee claim for the additional reason that they conferred no benefit on American or its stockholders.

To recover a fee from the class, plaintiffs must show that they conferred a benefit on it. Plaintiffs contend that the successive increases of Berkshire's merger offers from $275 to $650 a share were largely due to their efforts. The offers, however, were never accepted or carried out. They

* The single instance cited by the SEC, *Matter of Atlas Corp.*, 39 S.E.C. 437, 460-61 (1959), is inapposite. In that case, the petitioner had *agreed* to reimburse a participant. The Commission reviewed the agreement only to make sure that the fee was not excessive.

added nothing to American's assets. Nobody derived a benefit from them.*

According to plaintiffs, Berkshire's $650 settlement offer was an "admission" that such was the value of American's stock. Settlement offers are not, however, admissions; *West* v. *Smith,* 101 U.S. 263, 273 (1879); *Hawthorne* v. *Eckerson Co.,* 77 F.2d 845, 847 (2d Cir. 1935). Even if they were, the supposed admission of value was not a compensable benefit. Otherwise every stockholder who secures a favorable offer for his stock from the corporation could at once bring suit for a fee.**

Nor was the abandonment of the American-Berkshire merger a compensable benefit. Under the rule of *Mills, supra,* 396 U.S. 375, a class that has benefited from an action must reimburse the plaintiff's litigation expenses because the class "would have had to pay them had it brought the suit" (pp. 396-97). To deny such reimbursement "would be to enrich [the class] unjustly at the plaintiff's expense" (p. 392).

In the present case, no unjust enrichment of the class is possible. If plaintiffs had not participated in the SEC proceeding, the Commission would by itself have rejected an unfair merger; and it would have done so without any expense to American or its minority stockholders. Plaintiffs' intervention thus did not save them a dime of expense. Under the rule of *Mills,* they are, therefore, under no obligation to plaintiffs.

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* Plaintiffs allege that, after the termination of the SEC proceeding, Berkshire offered $600 a share or more for the outstanding minority shares of American. We need not discuss these post-SEC developments, since plaintiffs expressly disclaim any intention to invoke them as a ground for compensation (8, note; App. below 53A-54A).

** Despite the "admission", defendant Weininger had to spend more than $100,000 in counsel fees to secure for his stock an amount substantially less than that supposedly "established" by plaintiffs (9a-10a).

III.

Plaintiffs have no claim for "harassment" or "fraud".

Plaintiffs claim to be entitled to a fee because Berkshire's allegedly inadequate cash offers in the SEC proceeding constituted "harassment" and "fraud".

1. The "harassment" claim seems to invoke the familiar equitable rule that a court may "award attorney's fees in favor of one party and against another, where an unfounded action or defense is brought or maintained in bad faith, vexatiously, wantonly, or for oppressive reasons"; 6 *Moore's Fed. Pr.*, ¶ 54.77(2), p. 1709 (2d Ed. 1972); see *Stolberg* v. *Board of Trustees*, 474 F. 2d 485 (2d Cir. 1973). A party, such as plaintiffs, who *voluntarily* enters an administrative proceeding in which his rights are fully protected by the agency can hardly pose as a victim of harassment. As the Court below held, "[t]he extensive participation of LLB was voluntary and, as we have already noted, we cannot assume that the SEC would have failed to act without it" (9a).

In addition, a fee award under the equitable rule "rests in the sound discretion of *the trial judge*" (6 *Moore's, id.*, at 1716, emphasis added), for only the trial judge has the necessary familiarity with the case, *Green* v. *Transitron Electronic Corp.*, 326 F. 2d 492, 496 (1st Cir. 1964). If there was a "trial judge" in this case, the SEC played the part. Certainly the court did not. The court is, therefore, in no position to make the allowance sought by plaintiffs.

2. Equally far-fetched is plaintiffs' claim that they were "defrauded" by Berkshire's allegedly inadequate cash offers. Plaintiffs do not allege that they were deceived by Berkshire's supposed misrepresentations. On the contrary,

the complaint (¶¶ 7, 11, 12) alleges that plaintiffs participated in the SEC proceeding precisely in order to challenge Berkshire's valuation. Nor do plaintiffs contend that the SEC or any other person was deceived.

Moreover, plaintiffs do not assert that they were damaged by the alleged fraud. Their expenses in the SEC proceeding were not an element of damages. It "has long been the general rule in American courts . . . that attorney's fees may not be awarded as an element of damages except where specifically authorized by statute or by contract"; *Washington Aluminum Co.* v. *Pittman Const. Co.*, 383 F. 2d 798, 805 (5th Cir. 1967); *Fleischmann Distilling Corp.* v. *Maier Brewing Co.*, 386 U.S. 714, 717-720 (1967), and cases cited there and by the Court below (6a).

CONCLUSION

It was plaintiffs' privilege to spend whatever amounts they deemed necessary to protect their own investment in American's stock. Their individual stake in the SEC proceeding was more than $3,800,000 (7a). That was ground enough for plaintiffs to pay, as they did, substantial legal fees in their self-interest. But plaintiffs' attempt to foist their expenses upon defendants borders on the presumptuous. American and its stockholders did not ask for plaintiffs' protection. They did not need it. They derived no benefit from plaintiffs' efforts.

Congress has appointed the SEC to guard American and its minority stockholders from unfairness and overreaching in the proposed merger. The stockholders were satisfied to trust their statutory guardian. The Commission afforded them the full measure of its protection. The stockholders

cannot now be required to pay involuntary tribute for plaintiffs' unsolicited and unnecessary services.

The petition for a writ of certiorari should be denied.

Dated: March 8, 1974.

Respectfully submitted,

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